

## Message Text

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15

ACTION ARA-17

INFO OCT-01 ADP-00 CEA-02 L-03 SEC-03 AID-20 CIAE-00

COME-00 EB-11 FRB-02 INR-10 NSAE-00 RSC-01 TRSE-00

XMB-07 OPIC-12 CIEP-02 LAB-06 SIL-01 SAL-01 OMB-01

DODE-00 PA-03 USIA-12 PRS-01 NSC-10 SS-15 STR-08

RSR-01 /150 W

----- 016154

R 071837 Z APR 73

FM AMEMBASSY BRASILIA

TO SECSTATE WASHDC 7116

INFO AMCONSUL RIO DE JANEIRO

AMCONSUL SAO PAULO

AMCONSUL RECIFE

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E. O. 11652: N/A

TAGS: EFIN, BR

SUBJ: GOB DECISION TO INTERVENE IN SUPPORT OF STOCK MARKET

1. SUMMARY: AFTER MANY MONTHS OF STAGNATION ON A SLOWLY DECLINING TREND, WHICH BROUGHT THE RIO STOCK INDEX DOWN TO THE LEVEL OF LAST MONTHS OF 1970, MARKET SUDDENLY TURNED AROUND, AND INDEX ROSE BY OVER A THIRD IN 3 WEEKS.

2. BASIC REASON FOR RECOVERY WAS RUMOR, LATER CONFIRMED, OF GOVERNMENT DECISION TO INTERVENE IN MARKET BY MAKING FUNDS FROM PROGRAM FOR SOCIAL INTEGRATION ( PIS) AVAILABLE THROUGH CAIXA ECONOMICA ( GOVERNMENT SAVINGS INSTITUTION) IN FORM OF LOANS TO BROKERS TO PURCHASE STOCKS. DETAILS OF PLAN NOT ANNOUNCED BUT SAID TO BE UNDER PREPARATION IN CENTRAL BANK.

3. PROGRAM, IF IMPLEMENTED, WOULD REPRESENT IMPORTANT ECONOMIC POLICY ACTION DEMONSTRATING AGAIN WILLINGNESS OF PRESENT GOVERNMENT TO TAKE STRONG MEASURES WHEN SITUATION LIMITED OFFICIAL USE

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APPEARS TO REQUIRE THEM. END OF SUMMARY

4. AFTER MANY MONTHS OF SLOW BUT RATHER STEADY DECLINE, DAILY AVERAGE OF STOCK PRICES ON RIO STOCK EXCHANGE REACHED 1476 ON MARCH 16, LOWEST POINT SINCE LAST MONTHS OF 1970. THIS REPRESENTED HUGE DECLINE FROM PEAK OF 5237 REACHED ON JUNE 14, 1971. VALUE OF SHARES TRADED AT LOW POINT AVERAGED APPROXIMATELY CR\$10 MILLION PER DAY WHEREAS CR\$100 MILLION DAYS WERE COMMON IN MAY AND JUNE 1971.

5. BY MARCH 29 INDEX HAD RECOVERED TO 2010 WITH VALUE OF DAY'S TRADE CR\$52 MILLION. IN SUBSEQUENT DAYS INDEX RECEDED SLIGHTLY BUT STILL STOOD AT 1932 FOR APRIL 5.

6. IT SEEMS CLEAR THAT DRAMATIC TURN AROUND IN MARKET WAS DUE TO RUMOR, LATER CONFIRMED, THAT GOVERNMENT IS DEVELOPING PLANS TO SUPPLY OFFICIAL TRUST FUNDS IN FORM OF LOANS TO BROKERS WHICH WOULD BE USED TO PURCHASE SECURITIES AND THUS SUSTAIN THE MARKET. GOVERNMENT MAY ALSO, AS IT HAS IN PAST, PURCHASE SHARES OF INVESTMENT TRUSTS. SECURITIES PURCHASED BY BROKERS WOULD BE PLEDGED AS GUARANTEE OF REPAYMENT OF LOANS. IN PRESS CONFERENCE ON APRIL 3, 1973, MR. GIAMPAOLO DE FALCO, PRESIDENT OF CAIXA ECONOMICA, CONFIRMED THAT SUCH A DECISION HAD BEEN TAKEN BY MONETARY AUTHORITIES AND THAT CENTRAL BANK WOULD BE RESPONSIBLE FOR ESTABLISHING MECHANISM FOR RELEASE AND APPLICATION OF THE RESOURCES. FALCO SAID THAT HE COULD PROVIDE NO DETAILS OF PLAN. IT WAS FURTHER REPORTED THAT FRANCISCO DE BONI NETO, THE CENTRAL BANK DIRECTOR RESPONSIBLE FOR CAPITAL MARKETS, WOULD LUNCH WITH ADMINISTRATIVE COUNCIL OF THE RIO STOCK EXCHANGE ON APRIL 6 TO DISCUSS PROBLEMS INVOLVED IN PROVIDING LINES OF CREDIT FROM CAIXA TO BROKERS. THUS WHILE NO DETAILS CONCERNING IMPLEMENTATION OF PLAN HAVE BEEN ANNOUNCED, ALL INDICATIONS ARE THAT BASIC DECISION HAS BEEN TAKEN BY GOVERNMENT TO APPLY AN AS YET UNDISCLOSED VOLUME OF RESOURCES TO FINANCE PURCHASE OF EXISTING SECURITIES IN STOCK EXCHANGES TO HALT DECLINE IN STOCK MARKET PRICES AND IF POSSIBLE PROVOKE A TREND IN OPPOSITE DIRECTION.

7. COMMENT: ONE INTERESTING ASPECT OF SITUATION IS THAT LOW AND DECLINING LEVEL OF SHARE PRICES HAS NOT DETERRED FOREIGN INVESTORS WHO HAVE CONTINUED TO INCREASE THEIR INVESTMENTS IN BRAZIL IN MORE THAN TWO YEARS OF DECLINING PRICES. WHILE IT LIMITED OFFICIAL USE

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IS TRUE THAT OVERWHELMING PROPORTION OF NEW FOREIGN FUNDS ENTERING BRAZIL IS IN FORM OF LOANS, NEVERTHELESS DIRECT INVESTMENT INCREASED SUBSTANTIALLY IN 1972 AND ALL INDICATIONS ARE THAT THIS TREND IS CONTINUING. REPATRIATIONS OF EARLIER INVESTMENTS ARE VIRTUALLY NIL, AND REINVESTMENT OF EARNINGS IS VERY SUBSTANTIAL.

8. ANOTHER POINT IS BEHAVIOR OF BRAZILIAN INVESTORS.

CLEARLY THEY HAVE LOST INTEREST IN STOCK MARKET AS VEHICLE FOR INVESTING THEIR SAVINGS. PRICE EARNINGS RATIOS, WHICH ARE MUCH MORE FAVORABLE THAN THOSE WHICH DEVELOPED DURING THE EARLY 1971 BOOM, HAVE NOT YET BECOME SUFFICIENTLY ATTRACTIVE TO REVIVE INVESTOR INTEREST. THIS IS PERHAPS INEVITABLE IN AN INFLATIONARY SITUATION OF TYPE WHICH STILL PERSISTS IN BRAZIL. INVESTORS ARE ABLE TO OBTAIN FROM LETRAS DE CAMBIO (INSTALLMENT FINANCE PAPER) AND OTHER FIXED INCOME INVESTMENTS A SUBSTANTIAL REAL INTEREST RETURN, COUPLED WITH MONETARY CORRECTION OR ITS EQUIVALENT IN GROSS INTEREST, FAR SUPERIOR TO RETURN RECENTLY AVAILABLE FROM INVESTMENT IN SHARES.

9. GOVERNMENT HAS BEEN CONCERNED ABOUT PRICE TRENDS IN STOCK MARKET EVER SINCE DECLINE SET IN JUNE 1971. IT IS LIKELY THAT THERE HAVE BEEN COMPLAINTS FROM INVESTOR GROUP, INCLUDING MANY MILITARY PERSONNEL, THAT STOCK MARKET WAS IN SUCH POOR SHAPE. THERE MAY HAVE BEEN COMPLAINTS ALSO THAT GOVERNMENT WAS NOT DOING ENOUGH TO DEVELOP TECHNIQUES OF EQUITY, AS CONTRASTED WITH DEBT, FINANCING FOR BUSINESS INVESTMENT PURPOSES.

10. IT IS CERTAIN THEREFORE THAT GOB HAS BEEN WATCHING THE SITUATION CAREFULLY. ALTHOUGH IT IS TO BE DOUBTED THAT CENTRAL BANK WILL INDICATE SCALE OF ITS INTERVENTION, DECISION TO INTERVENE IS POTENTIALLY AN IMPORTANT ONE IN TERMS OF BRAZIL'S DEVELOPMENT POLICIES. IT SEEMS PROBABLE THAT GOVERNMENT, ONCE IT HAS TAKEN DECISION TO INTERVENE, IS DETERMINED TO MOVE FORCEFULLY, DEPLOYING A VOLUME OF RESOURCES SUFFICIENT TO HAVE AN IMPACT. THIS DEMONSTRATES ONCE MORE THAT PRESENT GOB ADMINISTRATION IS NOT HESITANT TO USE ITS POWER WHEN SOME NEW INITIATIVE IS REQUIRED TO INFLUENCE TREND OF SOME SEGMENT OF BRAZILIAN ECONOMY.

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11. USE OF SOME OF RESOURCES ACCUMULATED IN PIS PROGRAM TO ACQUIRE, OR TO PROVIDE FUNDS FOR BROKERS TO PURCHASE ALREADY OUTSTANDING SECURITIES, REPRESENTS A SACRIFICE IN TERMS OF ALTERNATIVE USES FOR THESE FUNDS. THEY HAVE BEEN INVESTED DIRECTLY IN INFRASTRUCTURE OR OTHER HIGH PRIORITY DEVELOPMENT PROJECTS. GOVERNMENT HAS EVIDENTLY DECIDED THAT THIS SACRIFICE IS WORTH THE RISK. HOPED FOR PAYOFF WOULD SEEM TO BE AT LEAST STABILIZATION OF STOCK MARKET PRICES, AND, IF POSSIBLE, STIMULATION OF RENEWED UPWARD TREND. ONLY IF SECONDARY MARKET FOR EXISTING SHARES BECOMES MORE FAVORABLE CAN THERE BE ANY SUBSTANTIAL VOLUME NEW ISSUES SUCCESSFULLY FLOATED IN MARKET. THIS IS ESSENTIAL TO CREATE FAVORABLE CLIMATE FOR EQUITY FINANCING THROUGH NEW SHARES.

12. RISKS WHICH GOVERNMENT IS TAKING IN MAKING DECISION TO  
SUPPORT MARKET WITH FINANCIAL RESOURCES ARE OBVIOUSLY SUBSTAN-  
TIAL. GOVERNMENT MUST HAVE ESTIMATED THAT DECLINE IN MARKET  
HAD REACHED POINT WHERE IT WOULD NOT GO MUCH LOWER AND COULD  
BE SUCCESSFULLY ARRESTED OR REVERSED BY INJECTION OF SOME  
NEW MONEY INTO MARKET. ONLY PASSAGE OF TIME WILL REVEAL  
CORRECTNESS OR ERROR IN THIS JUDGMENT.  
ROUNTREE

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